

August 18, 1997

Susan Brandon, President/Mgr.  
Members First Federal Credit Union  
10832 E. 31st Street  
Tulsa, OK 74146-2050

Re: Mechanical Breakdown Services  
Your letter dated May 21, 1997.

Dear Ms. Brandon:

Members First Federal Credit Union (the FCU) would like to market a mechanical breakdown service agreement to its members. You have asked whether the FCU may add \$125 to the cost of each agreement and, from that amount, retain \$100 for the FCU and pay \$25 as an incentive to the loan department employee who sold the agreement. You correctly noted in your letter that the answer depends on whether the agreement is insurance or a group purchasing plan.

If the Oklahoma Insurance Department classifies the agreement as insurance and the FCU sells an agreement in conjunction with financing the vehicle covered by the agreement, the FCU may add \$125 to the cost of the agreement. The FCU may pay the selling employee \$25 per agreement as an incentive, subject to certain conditions discussed below.

#### Analysis

Part 721 of National Credit Union Administration (NCUA) Rules and Regulations authorizes FCUs to make insurance and group purchasing plans involving outside vendors available to their members, to perform administrative functions on behalf of the vendors, and to be reimbursed by the vendors for those functions. The amount of reimbursement or compensation the FCU may receive depends on whether the agreement is considered insurance and whether it is sold in conjunction with an extension of credit.

As long as the state where a mechanical breakdown service agreement is sold classifies the agreement as insurance, and the agreement is sold at the time the vehicle covered by the agreement is financed, the FCU is not limited in the reimbursement or compensation it can receive. Thus, if Oklahoma classifies the agreement as insurance, and an agreement is sold in conjunction with financing the vehicle covered by the agreement, the FCU may add \$125 to the cost of each agreement.

If Oklahoma classifies the agreement as insurance, but the FCU does not sell it in conjunction with financing the covered vehicle, the FCU may receive an amount not exceeding the greater of the "dollar amount" or the "cost amount." Part 721 provides that the "dollar amount" is: \$4 per single payment policy; \$6 per combination policy; and \$4 per annum for any other type of policy. "Cost amount" means the total of the direct and indirect costs to the FCU of any administrative functions performed on behalf of the vendor. The FCU must be able to justify that amount using standard accounting procedures. Since \$125 exceeds the dollar amount, the FCU could add \$125 only if that is what it spends to market each agreement.

If Oklahoma does not classify the agreement as insurance, the FCU would be limited to receiving the cost amount for marketing the agreement.

You included with your letter a letter to you from Old Republic Minnehoma Insurance Company. The letter

indicates that "the specific agreement forms and rates" in the program you are considering have been submitted and approved by the Oklahoma Insurance Department but it is not clear whether Oklahoma regards the service agreement itself as insurance. Rather than rely solely on the insurance company, we think you should obtain an opinion on whether the service agreement is regarded as insurance from the Oklahoma Insurance Department or from an attorney of your own who is familiar with Oklahoma law. The FCU must assure itself of the correct classification of the agreement before determining how much it may retain for selling the agreement.

On the question of the FCU paying \$25 to an employee as an incentive for selling an agreement, there are two NCUA regulations that apply. Section 721.2 prohibits FCU directors, committee members, senior management employees, and other employees who are directly involved in an insurance or group purchasing activity from receiving any compensation, other than salary, in conjunction with the activity. However, employees who are directly involved in an insurance or group purchasing activity may receive compensation if the FCU board determines that the employee's involvement does not present a conflict of interest. Section 701.21(c)(8) prohibits FCU employees from receiving compensation, other than salary, in connection with a loan made by the FCU, with certain exceptions. There is an exception pertinent to your inquiry that allows an employee, other than a senior management employee, to receive an incentive in connection with a loan made by the FCU as long as the board has established written policies and internal controls regarding the incentive and monitors compliance with them at least annually.

The loan department employees selling the service agreements are directly involved in an insurance or group purchasing activity. In addition, if they are selling the agreements in conjunction with financing the covered vehicle, any incentive compensation they receive would be in connection with a loan made by the FCU. Therefore, if Oklahoma classifies the agreement as insurance, and the FCU sells an agreement in conjunction with financing the vehicle covered by the agreement, the FCU may pay the selling employee \$25 under the following conditions: 1) the employee is not a senior management employee; 2) the board determines that the payment does not present a conflict of interest; and 3) the board has established written policies and internal controls regarding the payment and monitors them at least annually.

Sincerely,

Sheila A. Albin  
Associate General Counsel

GC/LH:bhs  
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